NO. 22487

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

ROBERT W. NEES,

Petitioner,

vs.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

BRIEF FOR PETITIONER

APPEAL FROM
ORDER OF SECURITY AND EXCHANGE COMMISSION

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STATUTORY BASIS OF APPEAL

On July 14, 1967, by Order No. 34-8123 issued by respondent in a proceeding under §§15(b) and 15A of Securities and Exchange Act of 1934, petitioner was barred from association with a broker-dealer. Petitioner's Petition for Rehearing was denied by order of respondent dated November 1, 1967.

Thereafter petitioner filed a timely notice of appeal to this court.

This court has jurisdiction to review the orders of respondent pursuant to §9 of the Securities Act of 1933 and §25 of the Securities and Exchange Act of 1934.

(References herein are to pages of the transcript of

record unless otherwise indicated).

STATEMENT OF THE CASE

I

Proceedings to Date

On October 20, 1964, respondent issued its Order for Public Proceedings pursuant to §15(b) and §15A of the Securities and Exchange Act of 1934 (Order) to determine whether the broker-dealer registration of Century Securities Company should be revoked and whether certain persons including petitioner should be found to be a cause of the order of revocation of the aforementioned broker-dealer registration (1228-1232). The order alleged that during the period of January 1, 1963 to October 20, 1964 the respondents, singly and in concert, sold and delivered unregistered stock of JAYARK Films Corporation (JAYARK) and of Kramer-American Corporation (KAC) and made certain false and misleading statements in the offer and sale of such stock in wilful violation of the anti-fraud provisions of the Securities Act of 1933 and the Securities and Exchange Act of 1934.

Petitioner was duly served with the order for Public Proceedings and, pro se, filed a general denial (1259). On July 5, 1965, respondent Commission entered its Order for Hearing setting August 9, 1965 at Los Angeles, as the time and place of the hearing in such proceedings (1274), pursuant to which hearings were held before the Hearing Examiner on August 9, 25, 26 and 27, 1965, at which respondents thereto other than petitioner were

present, none represented by counsel (1-544). (Said hearings are hereinafter sometimes referred to as "the August hearings").

Said Order for Hearing was never served on petitioner, who had moved outside the State of California, and who, on learning of the August hearings, in September, 1965, moved to reopen the hearings for the purpose of interposing his defense (1361), which motion was granted by Order of the Hearing Examiner December 3, 1965 (1382), in which said examiner specifically found:

> "There is, therefore, a failure of proof that Nees has been duly notified of the hearing within the meaning of Rule 6(e). It follows that he did not default. Absent default, Rule 12(d) of the Commission's Rules of Practice providing certain conditions precedent to the granting of a motion to set aside a default does not apply,"

and thereupon ordered further hearing.

Such hearing was set for February 14, 1966 (1547). In conjunction therewith petitioner files Request for Clarification of Record (1548, 1565-1566), contending that pursuant to Rule 14(a), Rules of Practice of the respondent Commission, and 5 U.S.C.A. 1006(c), nothing stood in the record against him by virtue of the hearings of August, 1965, and that he was entitled in effect, to a hearing de novo (1561-1562).

At the reopened hearing February 14, 1966, contrary to

such contentions, the Hearing Examiner held the record of the August hearings stood against petitioner (547; 557-559). Such record included certain stipulations entered into during the August hearings by and between counsel for the Division of Trading and Markets of respondent Commission, the Division and the respondents thereto then present (6; 558).

At the hearing of February 14, 1966, the Division relied upon the record of the August hearings as constituting its case against petitioner; presented two investor-witnesses; asked each if his testimony would be substantially similar to that given in the August hearings; and rested its case (559-562; 593). Petitioner's counsel of record and the counsel for other respondents then conducted cross-examination of said witnesses (562-592; 594-596). Petitioner testified in his own behalf (596-609).

At the conclusion of the Division's case as thus presented, petitioner restated his objections to admission of the prior record relating to the August hearings (609).

On August 31, 1966, the Initial Decision of the Hearing Officer was filed sustaining against petitioner certain of the allegations of the proceeding and barring him from being associated with a dealer or broker (1669-1705), which decision relied upon testimony adduced at the August hearings and evidence admitted at said hearings pursuant to stipulation of respondents thereto other than petitioner.

Pursuant to Order for Review of Initial Decision (1754), the respondent Commission ordered a review, and on July 14,

1967, release No. 34-8123, issued its Findings and Opinion, in effect affirming the Initial Decision as to petitioner (2000-2012).

In said release the respondent Commission stated (2010):

> "The Hearing Examiner on December 3, 1965 concluded that there was a failure of proof that Nees had been duly notified of the hearing within the meaning of Rule 6(e) of our Rule of Practice, and ordered the hearings reopened to permit Nees to interpose a defense. Although Nees, in our opinion, was duly notified of the hearing, we think the examiner properly exercised his discretion in reopening the hearings."

Petitioner then filed a Petition for Rehearing of such action by respondent Commission, asserting inter alia that his constitutional right of due process had been violated in that he had not been granted a hearing de novo upon the charges against him. On November 1, 1967, respondent Commission issued its Memorandum Opinion and Order Denying Rehearing (2013-2017), stating with reference to Petitioner's contention:

> "Nees' argument with respect to the examiner's finding that he was not duly notified of the principal hearing - a finding with which we expressly disagreed - was discussed at length in our decision and our findings need not be repeated here." (2016)

Prior to the initial decision of the Hearing Examiner, respondent acknowledged it would make no proposed findings that any of the individual respondents, including petitioner, had sold unregistered shares of Kramer-American stock (1638).

In his Initial Decision the Hearing Examiner concluded that petitioner had wilfully violated §§17(a) of the Securities Act and §§10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c 1-2 thereunder. (1702). The examiner ordered that petitioner be barred from being associated with a broker-dealer and imposed lesser sanctions upon the other respondents (1704).

In its Findings and Opinion, in effect affirming the Initial Decision, respondent Commission ordered that all individual respondents be barred permanently from being associated with a broker-dealer (2011). This sanction was not changed by the respondent Commission in its Order Denying Rehearing (2013-2017).

II

The Facts of This Case

As already indicated, the Hearing Examiner ruled that the evidence introduced at the August hearings would remain a part of the record at the reopened hearing held February 14, 1966 at the request of petitioner, and he was then given "an opportunity to respond to such evidence as ha[d] been introduced" (549; 549-559). Counsel for petitioner then took the position, as is now taken, that such record, which included stipulations not

entered into by petitioner, could not stand against petitioner. The Hearing Examiner then acknowledged that a "good part of the record of the JAYARK--that portion of the record--was introduced by stipulation" (558), but held his ruling binding petitioner to the record of the August hearings must stand against petitioner (559).

Counsel for petitioner again objected that such record constituted rank hearsay against petitioner (560). The Hearing Examiner then asked of said counsel whether he had read the testimony of two complaining witnesses as recorded at the August hearings and ordered the hearing of February 14, 1966 to proceed, giving counsel only the opportunity to cross-examine such witnesses on the basis of their prior testimony as so recorded (561). Consequently, counsel for the Division of Trading and Markets merely asked each of said witnesses whether, if he were to testify on the same subject matter that day, February 14, 1966, his testimony would be the same as it was in August of 1965, to which the reply was affirmative (562-593). Thereupon said witnesses were turned over to counsel for petitioner for cross-examination (562; 593).

Petitioner then took the witness stand and testified that he had not, to his knowledge, ever sold unregistered shares of stock of any company involved in the proceeding (616), and was not aware that any shares of stock of JAYARK sold by him were, in fact, unregistered stock (617). He further testified that he was then employed as a registered representative by another broker-

dealer (617); that he had worked for nine years as a registered representative (619); and that he went to work for the respondent broker-dealer in July of 1963.

Counsel for petitioner once more objected so far as petitioner was concerned to the evidence previously introduced at the August hearings, making the following statement:

> "MR. EISENBERG: I now have before me the exhibits which were introduced, I take it, into evidence at the hearing which was conducted on August 9, 25, 26, 27, 1965, I would like to take this opportunity to object to each and every exhibit in there on the basis that there was either an improper or no foundation to their admission, that there was no oral or an improper authentication; there was no showing that the exhibits that were introduced were best evidence and that each and every exhibit in there is hearsay as to Respondent, Mr. Nees."

The Hearing Examiner overruled such objection on the basis of his prior ruling as previously referred to herein (633).

SPECIFICATION OF ERRORS RELIED UPON

The respondent Commission erred in denying petitioner's Petition for Rehearing, upon the ground that there was no substantial evidence to support the finding that petitioner had made false or fraudulent representations causing any investor to purchase JAYARK stock and the resultant order that petitioner be barred from association with any broker-dealer; the issuance of said order was in violation of petitioner's right to due process of law for failure to give him notice of the August hearing at which was adduced the substantial portion of evidence relied upon by the respondent Commission in said Findings and Order; said Findings and Order were and are contrary to law in that the same may not be entered against petitioner without support of evidence lawfully produced against him in his presence; the respondent Commission was without jurisdiction to make such findings and order in that the facts adduced purporting to establish such jurisdiction were in the form of evidence submitted and stipulations made at said August hearings in the absence of petitioner, without his consent, and without due notice to him of said hearing.

QUESTIONS PRESENTED

I

Was there evidence lawfully presented at the hearings conducted by respondent Commission sufficient to sustain a finding that petitioner had made false or fraudulent representations causing any investor to purchase JAYARK stock?

II

In the totality of the circumstances surrounding petitioner's hearing and being the subject to an order barring him from association with any broker-dealer, was he deprived of his right to due process of law?

(a) Was the respondent Commission bound by the finding of the Hearing Examiner that petitioner did not receive due notice of the August hearings?

(b) If petitioner did not receive such due notice, was petitioner bound by the record of the August hearings, at which he was not present, or was he entitled to a hearing de novo?

SUMMARY OF ARGUMENT

In the totality of the circumstances surrounding the hearings held before respondent Commission resulting in the issuance of a bar order against petitioner, petitioner did not receive a fair hearing within the concept of due process of law. Further, in the conduct of the hearings by the Hearing Examiner,

whose decision was confirmed by respondent Commission, rulings were made against petitioner which were contrary to law in substantial respects.

I

CONFIRMATION BY RESPONDENT COMMISION OF THE HEARING EXAMINER'S RULINGS DENYING MOTIONS AND OVERRULING OBJECTIONS OF PETITIONER WAS ERRONEOUS AND PREJUDICIAL.

A. TESTIMONY ADDUCED AT THE AUGUST HEARINGS MAY NOT BE HELD AGAINST PETITIONER

Section 5(c) of the Administrative Procedure Act (5 U.S.C.A. §1004(c)) provides, in pertinent part:

> " . . . no such officer [Hearing Examiner] shall consult any person or party on any fact in issue unless upon notice and opportunity for all parties to participate. . . "

It is an uncontroverted fact recognized by the Hearing Examiner himself that petitioner was not served with notice of the August hearings. In his Order reopening the record (1382) the Hearing Examiner found that petitioner had left a change of address with the post office and that such fact obviated the possibility of any attempt at avoidance of service upon him. Thus, the failure of service upon petitioner could not be attributed to fault on his part. On the other hand, the Division could have

assured itself that service was made upon petitioner simply by undertaking the same inquiry of the Post Office Department which the Hearing Examiner described in a footnote to his Order reopening the record. Therefore, it can be concluded contrary to the opinion of the respondent Commission (2010) that the failure to accomplish service on petitioner was due to the Division's negligence.

That negligence and the Hearing Examiner's rulings binding petitioner to the record of the August hearings were prejudicial to the rights of petitioner. The motions made on his behalf respecting applicability of that record arose precisely because of his absence from the August hearings due to lack of notice. It would be almost amusing, if the consequences to him were not so drastic to reflect upon the Division's assertion, made on page 4 of its Response to Request for Clarification of Content of Record, that petitioner "has not been diligent" and that his assertion of his fundamental rights of due process is "untimely" (1555). To accept such assertions would render meaningless the writs and procedures on appeal made available to protect the basic right of due process. Yet it is apparent in the final analysis that the Hearing Examiner and respondent Commission did accept them.

It is recognized that strict rules for the admission of evidence in courts of law may be relaxed somewhat in an administrative proceeding. But fundamental fairness must be preserved. Rosedale Coal Co. v. Director of U.S. Bureau of Mines, 247 F. 2d

299 (1957). Even in an administrative proceeding, one person cannot be held responsible for the actions and statements of another in the absence of conspiracy or agreement. In General Foods Corp. v. Brannan, 170 F. 2d 220 (7th Cir. 1948), the Court, dealing with a complaint alleging manipulation under the Commodity Exchange Act, stated (at p. 225):

> ". . . it is true, of course, as asserted by the government, that strict rules of procedure, including the admissibility of evidence, inherent in criminal and common law proceedings, are not applicable to administrative proceedings. But no court, so far as we are aware, and we do not propose to be the first, has held in an administrative proceeding or any other kind that one person can be held responsible for the actions and statement of another in the absence of a conspiracy or agreement."

The denial of the right of cross-examination and the basing of inference upon inference is not authorized even in the conduct of a hearing by an administrative officer, Automobile Sales Co. v. Bowles, 58 F. Supp. 469 (1945), nor can an administrative agency even limit the right of cross-examination unduly. Giant Food, Inc. v. F. T. C., 322 F. 2d 977, 116 U. S. App. DC 277, cert. dismissed 84 S. Ct. 1121, 376 U. S. 967, 12 L. Ed. 2d 82 (1963).

In the instant case, petitioner was denied completely the

right to cross-examine all but the two investor witnesses called to the re-opened hearing held February 14, 1966. When all is said and done it may be seen that it took the testimony of other witnesses, plus stipulations by the other parties plus evidence admitted without objection by the other parties all at the August hearings to constitute even a prima facie case against petitioner.

B. THE HEARING EXAMINER'S RULINGS RESPECTING THE RECORD AGAINST PETITIONER WERE ERRONEOUS UNDER THE RESPONDENT COMMISSION'S OWN RULES OF PRACTICE

Under the respondent Commission's own Rules of Practice, a deposition may be taken only after a showing that "a prospective witness may be unable to attend or may be prevented from attending a hearing, that his testimony is material and that it is necessary to take his deposition in the interest of justice." (S. E. C. Rules of Practice 17 C. F. R., §201. 15(a).) Provision is also made for notifying the other parties. The right to cross-examine a deponent, and to object to questions or evidence, are expressly assured at the time the deposition is taken. (S. E. C. Rules of Practice, 17 C. F. R., §201. 15(a).)

It is significant that the respondent Commission's Rules of Practice then go on to provide that a deposition, even though cross-examination is assured at the time the deposition is taken, may be admitted into evidence only if it can be shown that the witness is unavailable to testify at the hearing or, "upon application

and notice, that such exceptional circumstances as to make it desirable, in the interest of justice and with due regard to the importance of presenting the testimony of witnesses orally in open hearing, to allow the deposition to be used." (S. E. C. Rules of Practice, 17 C. F. R., §201. 15(b).) [Emphasis added]

It appears obvious that in framing the foregoing provisions of its own Rules of Practice, the respondent Commission proceeded with three recognized principles in mind:

a. The right to cross-examine at each stage of the proceeding at which testimony is taken, even as to a deposition which may never be used, must be preserved.

b. The right to object to questions or evidence at each stage of the proceeding, even as to a deposition which may never be used, is essential to a fair trial.

c. ". . . [T]he importance of presenting testimony of witnesses orally in open hearing. . ." is universally recognized as enabling the trier of fact to observe the demeanor of witnesses, to hear their tone of voice, to see their carriage, to listen for their pauses in answering questions, "to judge of their characters by their faces" [1/] while giving testimony.

1/ Wellman, The Art of Cross-Examination, p. 8 (4th Ed., 1932)

> It is, likewise, the only means by which an adverse party can properly prepare for the ordeal of cross-examination. A transcript is but a poor substitute for oral testimony. The respondent Commissions's own Rules of Practice recognize this fundamental principle.

Petitioner clearly was denied these rights. In effect, the evidence admitted into the record as against him prior to the August hearings, either by stipulation of the other parties or without objection by the other parties, implicitly was held to be binding upon him, even though he was neither present nor represented at the time, and no foundation for the admission of such evidence as against him was ever made. His objections to this procedure were summarily overruled by the Hearing Examiner and blithely ignored by the respondent Commission.

There is more than a touch of irony in the observation that, if the oral testimony elicited before petitioner became a participant in the later (August) hearings and now being used against him, had been adduced by deposition, the Commission's Rules of Practice as shown would protect Nees from this negation of his fundamental rights to object to questions and to cross-examine at the time the testimony was adduced. Moreover, this observation is even more appropriate with respect to the evidence introduced without objection by other parties or stipulated into the record by other parties used to make out a case against petitioner.

The procedure employed mocks the standard of substantial justice and fair play which the Rules of Practice purport to represent.

> "We hold that defendant's reception of evidence, out of the presence of plaintiffs and without notice to them or their attorneys, if proved, deprived plaintiffs of a fair hearing, in violation of due process under the 5th amendment to the constitution of the United States. . . . "
>
> Brown-Pacific-Maxon Co. v. Toner,
>
> 255 F. 2d 611 (7th Cir. 1968).

II

THE FINDINGS OF FACT IN THE INITIAL DECISION AND FINDINGS AND OPINION OF RESPONDENT COMMISSION ARE CLEARLY ERRONEOUS

There was no proof of jurisdiction of or the falsity of any representation allegedly made by petitioner. Only two witnesses were called by the Division to testify at the second hearing. Both of these were investors who had testified for the Division at the August hearings. In substance, each in turn was asked by Division counsel whether he would testify to the same answers, if asked the same questions as at the original hearings; replied affirmatively; and was turned over for cross-examination.

The Court is respectfully urged to read carefully the testimony of these two witnesses upon cross-examination and to note

the contrast from their testimony at the original hearings. It will be observed that Book's testimony, relatively smooth and consistent at the original hearings, because confused and self-contradictory when cross-examined at the second hearing. Subtle but important and crucial distinctions in representations attributed to petitioner appeared upon cross-examination. The value of confrontation at the time direct testimony is elicited was never more vividly illustrated.

> "We do not think the weight of the facts can attach very much importance to the testimony of a witness who testifies both ways on the same point." General Foods Corp. v. Brannan, 170 F. 2d 220, 227 (7th Cir. 1948).

The only other witness, Heuvel, failed to make any assertion on cross-examination detrimental to petitioner.

No jurisdictional evidence was introduced at the second hearing. No proof of falsity was offered. No documentary evidence was offered. Yet the Hearing Examiner found no difficulty in attributing to petitioner facts introduced into the record at the first hearing upon stipulation of the other parties or in the absence of objection by the other parties.

This procedure, convenient though it may be for the Division to follow, lacks even a modicum of fairness.

> "To experienced lawyers it is commonplace that the outcome of a lawsuit -- and hence the

vindication of legal rights -- depends more often on how the factfinder appraises the facts than on a disputed construction of a statute or interpretation of a line of precedents. Thus the procedures by which the facts of a case are determined assume an importance fully as great as the validity of the substantive rule to be applied. And the more important the rights at stake the more important must be the procedural safeguards surrounding those rights."

Speiser v. Randall, 78 S. Ct. 1332, 357 U.S. 513, 2 L. Ed. 2d 1460 (1958), re-hearing den. 79 S. Ct. 12, 358 U.S. 860, 3 L. Ed. 2d 95.

III

THE RESPONDENT COMMISSION WAS BOUND BY THE HEARING EXAMINER'S FINDING RESPECTING NOTICE TO PETITIONER

As may be seen from the record, the respondent Commission in its Findings and Opinion affirming the Initial Decision of the Hearing Examiner, took note of the examiner's finding that petitioner had not been notified of the August hearings and then went on to state that in its opinion petitioner had been duly notified of such hearings but that the examiner had "properly exercised his discretion in re-opening the hearings.". (2010) In its Order Denying petitioner's request for rehearing respondent Commission

expressly disagreed with the finding of the Hearing Examiner (2016), so that it may well be said that the respondent Commission has almost blithely ignored the important and significant finding as to due notice.

It is submitted that the finding of the Hearing Examiner to the effect that petitioner had not been given due notice of the first four days of hearings (the August hearings) must stand despite the respondent Commission's attempt to brush it aside. In a proceeding to review an administrative order, the Court of Appeals cannot lightly brush aside findings of the trial examiner even though such findings were rejected by agency. United States Steel Company v. National Labor Relations Board, 196 F. 2d (1952). See Allentown Broadcasting Corporation v. Federal Communications Commission, 222 F. 2d 781 (1954); National Labor Relations Board v. Local 160 International Hod Carriers, Etc., 268 F. 2d 185 (1959).

It would appear that when the Hearing Examiner has taken into consideration the affidavits in support of petitioner's request to re-open the hearings as to him, directly heard the arguments of counsel in these respects, and made a finding of fact based thereon, the respondent Commission must, under the foregoing authorities be bound by such finding so far as the question of due notice is concerned. It is elementary that when an administrative agency decision is not supported by the record as a whole when Hearing Examiner's decision is included, the Appellate Court may reverse. Burton-Dixie Corporation v. Federal Trade Commission, 240 F. 2d 166 (1957).

IV

IN THE TOTALITY OF THE CIRCUMSTANCES PETITIONER HAS BEEN DENIED FUNDAMENTAL RIGHTS OF DUE PROCESS

The issues presented by the record are clear:

(1) If petitioner was not notified of the August hearings, as found by the Hearing Commissioner, should the record of such hearings (including stipulations affecting jurisdiction in which he did not join) have been admitted against him in the later (February, 1966) hearings?

(2) Even if the respondent Commission acted lawfully in overruling such finding by the Hearing Commissioner, should the record of the August hearings have been admitted against him in the later (February, 1966) hearings?

Petitioner has already submitted that based on the record a patent error was made by the respondent Commission resulting in violation of the most basic of constitutional rights to be accorded petitioner, his right to due process. It is incontrovertible that the Hearing Examiner expressly found petitioner had not been duly notified of the August hearings (which lasted four of the total of five days involved) yet admitted against him the full record of such hearings, at which petitioner was not present and at which stipulations concerning substantial matters were entered into in order to establish the case found against the petitioner by respondent Commission.

This compounding of error was further compounded by

the respondent Commission in its final position as taken in its Memorandum Opinion denying rehearing: that it disagreed with the Hearing Examiner's ruling that petitioner had not been duly notified of the August hearings.

It should be noted, too, that no attempt was made at the re-opened hearing of February 14, 1966, at which petitioner was finally present, to have him enter into the stipulations agreed to by the other respondents at the time of the August hearings. Such stipulations were essential to the establishment of a prima facie case against petitioner, and even if the record of the August hearings was properly held to stand against petitioner, he could not be bound by stipulations never proposed or agreed to by him.

Basic to the requirement of due process of law as under the Fifth Amendment to the Constitution of the United States, is the concept of fairness and reasonableness. It has been said that where "in the totality of the circumstances" the procedures were so unfair as to deprive petitioner of a fair trial, due process has been denied. Stoval v. Denno, 388 U.S. 293, 87 S.Ct. 1967 (1967); United States v. Meyers, 381 F. 2d 814, 816-817 (1967). The question whether an administrative decision is supported by substantial evidence goes to the reasonableness of what the agency did on the basis of the evidence before it. J. A. Terteling & Sons, Inc. v. United States, 390 F. 2d 926 (1968).

Surely it may be seen that in the context of this case, "in the totality of the circumstances", the action of the Hearing Examiner, despite his finding of lack of due notice, in admitting

the record of the August hearings against petitioner was unreasonable and unfair, and constituted a substantial violation of the rules of evidence. Worse, the ambivalent position asserted by respondent Commission in saying at one and the same time that the Hearing Examiner acted within his discretion in re-opening the hearings as to petitioner, and that in respondent Commission's opinion there had been due notice given, creates not only an aura of unfairness and unreasonableness, but of confusion and lack of the kind of precision required in law.

However one characterizes the action of the Hearing Examiner and of the respondent Commission, it seems clear, as a whole, that a mistake has been made by the respondent Commission. In such a situation, the Court of Appeals may vacate the findings of the administrative agency; in the case at hand it appears the court must do so. See Ng Yip Yee v. Barber, 267 F. 2d 206 (1959).

CONCLUSION

For the reasons stated, it is respectfully submitted that the order of respondent Commission barring petitioner from association with a broker-dealer should be reversed and the cause remanded, with an order directing a new hearing.

Respectfully submitted,

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